

Unrelated business income; sale of space in journal. Income derived by an organization, exempt under section 501(c)(3) of the Code, from the sale of space in its journal for advertising, except space for 60-to-the-page listing that merely identify the purchaser without a further advertising message, constitutes unrelated trade or business income; Rev. Rul. 74-38 clarified.

Advice has requested whether the amounts realized in connection with the publishing activities described below constitute income from the conduct of unrelated trade or business within the meaning of section 513 of the Internal Revenue Code of 1954.

An organization exempt from Federal income tax under section 501(c)(3) of the Code publishes a journal containing articles and other editorial material which contribute importantly to the accomplishment of its exempt purposes. The organization derives income from the sale of space in its journal for conventional advertising or such other messages as the purchasers direct. Some of the space sold for such purposes is devoted to ordinary advertising that features the products or services of a commercial enterprise. Most of the space, however, is merely used to identify the purchaser and contains no advertising message. Any given purchaser of advertising space can elect to have his identity withheld from publication, if he so chooses.

The organization's journal is published six times annually and has an estimated nationwide circulation of 10,000. Substantially all copies are distributed without separate charge to dues-paying members. A few copies are sold and some are given away. A representative issue of the journal consists of 95 pages of which 60 are devoted to identifying various national and local business firms in separate 'blocked-in' spaces (full page, 1/2, 1/3, 1/4, 1/5, 1/8, 1/10, and 1/16 page) or part of 'listings' (listing of 60 or more firms per page). The business firms identified in the separate spaces are further identified in an Index of Advertisers.

Solicitation for advertising from large firms is made by contact with the chief executive officer or the officer in charge of community relations rather than the advertising manager. Local ads and listings are solicited by having local members call on merchants. In addition to personal contacts, solicitation is made by form letter in the following manner:

This letter is a direct appeal for your support; be it in the form of a personal or corporate contribution. Or perhaps, you might peruse the enclosed edition of our journal, and find it possible to take out an advertisement at the cost listed on the enclosed rate card.

Rates for space begin at \$25 for a 'listing' and up to \$1,500 for a full page.

The question is whether and to what extent amounts realized from the foregoing activities constitute income from the conduct of unrelated trade or business within the meaning of section 513 of the Code.

The term 'unrelated trade or business' is defined in section 513(a) of the Code as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt purposes.

Section 513(c) of the Code provides that for the purposes of this section the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Section 1.513-1(d)(4)(iv) of the Income Tax Regulations provides that in certain cases activities carried on by an organization in the performance of exempt functions may generate good will or other intangibles which may be exploited in commercial endeavors. Where an organization exploits such intangibles in commercial activities, the mere fact that the resultant income depends in part upon an exempt function of the organization does not make it gross income from related trade or business. Example (6) of this section provides that income from commercial advertising in a journal of an exempt association is gross income from unrelated trade or business.

Rev. Rul. 74-38, 1974-1 C.B. 144, holds that income derived by a state association of law enforcement officials, exempt under section 501(c)(6) of the Code, from the sale of space in its journal either for conventional advertising or merely to identify the purchasing organization without a further advertising message constitutes unrelated trade or business income under section 513.

The rationale underlying Rev. Rul. 74-38 is that the good will expected to be derived from the identification of the firm in the manner described therein is considered a form of commercial benefit that would be more than inconsequential.

Rev. Rul. 74-38 is based on the facts described therein. However, the mere identification of a firm in a journal is not determinative of whether the firm expects to obtain something more than an inconsequential amount of commercial benefit from its identification. Since any given purchaser of a vertising space can elect to have his identity withheld from publication,

all those who do not do so can ordinarily be presumed to expect to obtain something more than an inconsequential amount of commercial benefit. However, this presumption is not conclusive for any advertising patron whose patronage would nonetheless be difficult to justify on a commercial basis in view of all the circumstances in a given case. Among other factors that should be taken into account in all such cases are: the manner in which the publication under consideration is normally circulated; the territorial scope of such circulation; the extent to which its readers, promoters, or the like could reasonably be expected to further the commercial interests of the advertisers by either direct or indirect means; the eligibility or noneligibility of the publishing organization for the receipt of tax deductible contributions; and the commercial or noncommercial flavor of the methods used to solicit the advertising patronage in question.

With respect to the 'listings' described herein, it is concluded that the purchaser of a listing neither expects nor receives more than an inconsequential benefit therefrom. Any commercial benefit that could reasonably be expected to be derived from the appearance of the commercial name along with at least 59 others on a single page cannot be considered as other than negligible and inconsequential in view of the type of publication that the organization's journal is and the nature of the solicitation that resulted in the payments associated therewith. It is further concluded, however, that under the circumstances stated the business firms that are identified in the separate 'blocked-in' spaces and full pages of the journal, as well as in the Index to Advertisers, reasonably expect and receive some consequential amount of commercial benefit from their payments to the organization. Although some of these firms may have been motivated, in part, by charitable purposes in making their payments, the overall appearance and setting of their distinctly located notices clearly tend to give such notices a definite business aspect and thus provide a logical basis for concluding that the firms identified therein expect to receive more than an inconsequential amount of commercial benefit therefrom.

Accordingly, the amounts derived from the publication of the advertising in question, except from the listings, constitutes gross income from unrelated trade or business within the meaning of section 513 of the Code.

Rev. Rul. 74-38 is hereby clarified.